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WORKING SIDE BY SIDE:
Small, Medium & Large Businesses Working Together in Egypt

A Study on Business Linkages

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To a more limited degree, small businesses are employed in the manufacturing sector (22 percent). High volume and high quality requirements were usually given as reasons firms did not utilize small businesses for their manufacturing needs.

Smaller businesses are often left outside the "linkage" system due to the risk adverse stance of most larger firms. Small firms are usually relegated to the low-tech, time insensitive manufacturing and service areas. As a result, smaller Egyptian firms have not been able to adequately benefit from many linkage opportunities.

Other Forms of Linkages

The field survey found very few cases of franchising, unbundling, and brokerage services. Examples of local franchising and unbundling do exist, however they did not appear to be a common form of business linkage in Egypt.

Although the use of brokers to facilitate business linkages was found to be uncommon, the need for these types of services was regularly mentioned by respondents. Key informants asserted that the limited use of brokers was related to their availability. Albeit that many businesses are able to find small business contacts through word of mouth, most agreed that brokerage assistance would greatly benefit their businesses.

Key Constraints to Developing Business Linkages in Egypt

The constraints that impede business linkages in Egypt are common among all developing countries. For the most part, constraints exist at the small business level - in terms of lack of quality control, management, marketing, skills, and access to credit. The result of these constraints is consistently low-quality products and services, which discourages further affiliations with larger firms.

In addition to issues at the small business level, business collaboration is also constrained by the existing economic and policy environment.

Below are the key themes derived from the interviews concerning limitations to greater interaction between large and small businesses in Egypt.

Quality Control - most complaints from large businesses centered on issues of quality. Lack of quality control by small businesses was a distinct theme found in every interview and was considered a significant barrier to increasing business linkages (100 percent).

Management - the lack of sound management skills and business practices in small enterprises was another central theme in their relationships with larger businesses (64 percent).

Marketing and Information - lack of marketing and access to information were considered key constraints to developing business linkages between small and large firms. Almost 50 percent of the businesses interviewed mentioned that small businesses' inability to market their products and services was an obstacle to identifying potential partners.

Skills - businesses interviewed were not satisfied with the skill level of Egyptian workers. Lack of technical and managerial skills in small businesses were considered a major constraint to increasing working relationships with larger businesses (51 percent).

Credit - credit was identified by all the smaller businesses interviewed as a constraint to their growth and expansion. Lack of credit was noted by large firms as limiting small businesses' access to appropriate machinery, technology, and training (25 percent).

Economic and Policy Environment - Egypt's policy and regulatory environment hinders business linkages. Through its lack of uniformity, overlapping regulations, and general bureaucratic ineptitude, the Government of Egypt has created a cumbersome environment for business growth, expansion, and diversification. Policy constraints raised by key informants for this study include the following: (1) an ill-functioning legal framework; (2) the government's slow privatization policy; (3) a confusing and burdensome tax system; (4) high and inconsistently-applied import duties; (5) government domination of key sectors; (6) local content requirements; (7) cumbersome labor laws; (8) non-enforcement of intellectual property rights; (9) lack of proper training in the educational system; and (10) general ineptitude and incompetence of the bureaucracy.

Business Linkage Development

Business linkages can be encouraged by addressing many of the issues presented above. Successful cases of exploiting business linkages to resolve these constraints come from around the world. Key lessons emerge from these programs in the form of programming characteristics for business linkage programs. These include the following:²

Market Driven Business linkage projects should build on demands from the business community.

Collaboration Business linkage projects must seek to build and solidify collaborative partnerships between and among businesses. Through this process enterprises will be able to share information, technologies, and management practices.

² Many of the concepts presented here are taken from the ground breaking work done by John Grierson and Donald Mead in Zimbabwe; based on their report entitled, *Business Linkages in Zimbabwe: Concept, Practice, and Strategies*, GEMINI Working Paper No. 49. Washington, D.C.: USAID, 1995.



Institutional Arrangements	Business linkage projects should build on existing local institutional efforts. Care must be taken to establish clear lines of authority and coordination among all government entities involved in business development.
Information	A business linkage project's access to information can provide a centerpiece to initiate dialogue among businesses and a point of departure for further collaboration.
Policy Orientation	Business linkage efforts must be sensitive to the overall economic and policy environment. Projects must be designed based on these conditions and allow linkage initiatives to take on market-driven characteristics.

Business linkage assistance programs have met with varying degrees of success. These initiatives have been plagued by a lack of private sector involvement, inconsistencies in program implementation, and unfriendly policy environments.

The most successful programs have been able to supply targeted, responsive services to businesses. More general, broadly-targeted programs have achieved poor results. Though expensive, targeted and hands-on programs seem to have better results in expanding business linkages.

Potential Interventions

Targeted interventions need to be designed to increase business linkages in Egypt. The key to these efforts will be to garner the support of the private sector to solicit their ideas and concerns about future collaboration. The private sector must be involved in every stage of program design, preparation, and implementation.

A sub-sector analysis should first be conducted to identify the most viable sector to promote business linkages. In general, sectors will be characterized by: (1) limited public sector involvement; (2) a wide range of small businesses; (3) the potential for technological advances; (4) an active private sector; and (5) limited impediments to expansion and diversification.

Based on the information gathered in the sub-sector analyses, a pilot program could be implemented focusing on one or two of the identified sectors. This pilot program could test the waters for a larger endeavor, as well as develop several illustrative examples of business linkages.

The pilot program will provide a forum to test the viability of future interventions such as: (1) the need for contract mediation and support; (2) the cost and productivity of building a database of buyers and sellers; and (3) opportunities to provide directed technical assistance.

Conclusion

This study provides a wealth of evidence on the significance of small, medium, and large businesses working together in Egypt. By working side by side, they support the private sector's specialization, lowering transaction costs, and allowing firms to more readily meet changing market conditions.

The evidence in this report, gathered through key informant interviews, demonstrates that there is an active business linkage system throughout Egypt. Large businesses turn to smaller ones, and small firms work together to meet their production and service needs.

Egypt is faced with a host of institutional, technological, and environmental constraints to its business sector. The wide range of governmental bodies involved in business development - combined with an ineffective and inefficient policy and regulatory environment - inhibits business collaboration.

The country is also faced with constraints at the small business level, including a lack of access to new technologies and information, an insufficiently trained labor force, and poor management and business practices.

It will take a concerted effort to address these conditions. Business linkages may offer one opportunity, among others, to assist the country to embrace more market-driven approaches. The main challenge for the country will be to find its own methods to successfully expand the economy while working within its current political, social, and cultural climate.

INTRODUCTION

Small, medium and large businesses work in competition and collaboration in all economies. These relationships -- or linkages-- have been studied in various settings to better understand their positive and negative impact on business growth and development.

USAID's interest in business linkages originates from its work with small and micro enterprises (SMEs) in Egypt over the past eight years. Through these credit-oriented activities, USAID has recognized various needs of small enterprises that extend beyond credit. These needs stem from problems that include narrow access to new markets and new technologies; lack of information and communications systems; limited business and managerial skills; and a lack of properly skilled workers.

Business linkages have been identified as a potential mechanism to support small business growth by providing access to up-to-date technologies, new markets, training, management and technical skills, as well as credit. Based on these assumptions, the purpose of this study is to:

- ◆ Gain a better understanding of small and large firm linkages in Egypt
- ◆ Assess the scope of business linkages in Egypt
- ◆ Evaluate the constraints to business linkage development
- ◆ Provide USAID with technical guidance and recommendations in the field of business linkage development.

The methodology for this report included: (1) a literature review of existing research on the international business linkage experience; (2) a synthesis of the research conducted on business development in Egypt; and (3) key informant interviews. Interviews were conducted with over forty large and small businesses, non-governmental organizations, and banking and finance groups in late 1995; these were selected from Cairo, Alexandria, and Port Said. See Annex A for a list of companies and individuals interviewed.

This report is divided into five sections. Section One introduces business linkages and their importance to small and micro enterprise development. Section Two presents the study's findings on business linkages in Egypt. Section Three summarizes the constraints that impede business linkages in Egypt. Section Four outlines methods for designing business linkage projects. Section Five describes the potential for new business linkage endeavors in Egypt.

CHAPTER I

BUSINESS LINKAGES

What are Business Linkages?

Business linkages exist in every economy. These business arrangements can be complex or simple, and can have positive or negative implications for the firms involved.

A business linkage is a collaborative relationship among for-profit enterprises. It consists of firms of any type or size, including work performed at home, on the street, or in the workshop.

Business linkages can involve payment for goods or services or can be an exchange of information. Sometimes a business linkage may involve providing management support or training. On other occasions, it may consist of financial support or technical guidance.

The purchase of a product or service is the most common form of business linkage. This is usually referred to as sub-contracting and can range from one-off contracts to long-term relationships that include technical assistance.

Franchising is another well known form of business linkage. These relationships are formed when one firm allows another enterprise to produce their product or service according to predetermined specifications.

Potential Impacts

Although business linkages have been slow to occur in developing economies, they offer a variety of benefits for small and micro enterprises. Business linkages can operate as a mechanism to transfer knowledge from the buyer to the supplier concerning which products are in demand, new production technologies and management skills, raw materials and machines required to produce the right products, and where they can be obtained.³

These types of collaborations can help small and micro enterprises develop the capacity to increase their efficiency, upgrade their technology, and improve their technical and managerial skills. Documented experiences also reveal that business linkages can help SMEs gain the technical and managerial capacity to meet international quality standards.

³ John Grierson and Donald Mead. *Business Linkages in Zimbabwe: Concept, Practice, and Strategies*. GEMINI Working Paper No. 49. Washington, D.C.: USAID, 1995. p. 12.

There has not been a great deal of research on the potential impacts of business linkages. The few cases studies conducted in Africa and Asia do indicate some very positive opportunities. As noted by one expert in the field of business linkages:

Viabile linkages can facilitate specialization and constitute a cost-effective means of promoting the growth of small producers. By providing access to larger and more dynamic markets, and drawing small, indigenous enterprises into the mainstream of the economy, linkage relationships can enhance income levels and contribute to overall economic efficiency.⁴

Still, the development literature on business linkages has also thrown caution on the assumption that linkages are entirely beneficial. For example, a study conducted by UNIDO in 1974 noted that small enterprises linked as sub-contractors to large buyers were exploited in terms of price, and occasionally reduced to a stage of "peonage" by their partner.⁵

Other studies, such as that conducted by the Development Research Institute of the University of Tilburg on sub-contracting (entitled "Sub-Contracting as a Development Tool"), found few benefits for small businesses. This study shed light on the potential dangers of smaller companies working for larger firms and the contractual power imbalance inherent in these relationships. In addition, the findings from this research found few of the positive benefits of sub-contracting, such as access to new technologies, credit, or market opportunities.

These very different perspectives are important to keep in mind when assessing business linkages as a potential development mechanism. As little empirical data is available on the subject, care should be taken in evaluating its merits according to prevailing economic conditions. Recommendations -- such as those made by the Dutch study -- included addressing power imbalances by strengthening "interfirm networks" that would help smaller businesses approach larger businesses on more equal footing.

This report provides anecdotal evidence that firms in Egypt do benefit from collaborative, profitable relationships -- such as sub-contracting. The following example provides one such case where a multinational is working closely with a small, local manufacturer of cocoa.

⁴ Grierson, John and Sam Moyo. *Advocacy, Enterprise Extension and Indigenous Enterprise Institution Development*. Harare, Zimbabwe: NORAD, 1993. p. 30.

⁵ Lall, Sanjaya. *Vertical Inter-Firm Linkages in LDCs: An Empirical Study*. Oxford Bulletin of Economics and Statistics. Vol. 42 No. 3 August, 1980. p. 209.

Working Together: Businesses Helping Businesses

One multinational operating in Egypt has begun working with a local producer of cocoa in Upper Egypt. Although the local manufacturer (with about 35 employees) has the necessary equipment to produce high-quality cocoa butter, it currently does not have the technical capacity to do so.

The multinational has made a long-term commitment to this manufacturer to upgrade their skills and help them buy better quality cocoa beans. The multinational sends one of its engineers to Sohag on a regular basis to oversee the production and upgrading process.

The multinational has also promised to purchase a portion of their output as long as they maintain certain quality standards. In the long-run, the multinational hopes to obtain all of its cocoa needs from this local factory.

The above example is supported by findings from a 1994 World Bank study entitled, *Linkages Between Egyptian and Foreign Firms*. This study found that Egyptian firms working with international organizations have realized significant benefits, such as⁶:

- ☞ Increased revenue - from higher sales of raw materials, intermediate goods, and services; both locally and internationally.
- ☞ Increased productivity - as a result of technical and managerial improvements in the firms' operations.
- ☞ Upgraded business practices - due to the demand for the development of long-term business plans and improved customer satisfaction.
- ☞ Improved quality - due to the demand from multinationals for a uniform quality of goods and services. This has resulted in: (1) the introduction of better production processes; (2) more consistent application of strict quality control methods; (3) improved inventory and delivery practices; (4) better packaging; (5) more up-to-date office technology; and (6) improved human resource development.
- ☞ Diversification - of products and services through greater access to new sources, often from client referral from the multinational

⁶ These points were taken from the World Bank study entitled, *Linkages Between Egyptian and Foreign Firms*. p. 73.

The World Bank study also indicated that benefits are not limited to Egyptian firms working with multinationals. In fact, many of the benefits noted above filter down to the Egyptian firms' suppliers and sub-contractors. Therefore, as the multinational's demands increase with regard to its Egyptian sub-contractor or partner, the Egyptian firm's standards also rise with its suppliers and sub-contractors. In the long-run, the small and medium-sized firms indirectly benefit from large-scale business affiliations.

Conclusion

There are considerable advantages to be secured through business linkages between small, medium, and large firms. Long-term commercial partnerships benefit the economy in a variety of ways: lowering transaction costs; supporting the specialization and diversification of the private sector; encouraging information sharing and collaboration among firms; and improving the quality of product and service delivery.

Business linkages also have potential drawbacks. Although limited evidence is available on impact issues, there are indications that these relationships can be harmful to smaller businesses.

As will be seen in the sections below, one of the barriers to business linkages in developing economies has been the limited capacity of SMEs to provide the needed quality of goods and services in a reasonable time frame. Their inability to meet these standards impedes the development of further relationships with medium and large businesses, and in turn diminishes their own prospects of improvement. This, coupled with a difficult policy environment, has created an inhospitable environment for business linkages to flourish in Egypt.

CHAPTER II

DO BUSINESS LINKAGES EXIST IN EGYPT?

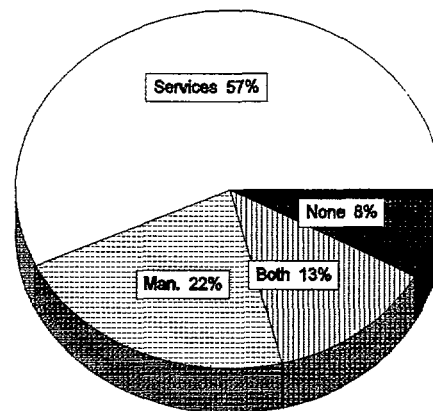
Business linkages do exist in Egypt and are an important part of the country's economy. Many businesses rely on other businesses to supply raw materials, inputs, and technical/specialized services.

The sections below describe the findings from the field investigation regarding different forms of linkages such as sub-contracting and franchising.

Sub-Contracting

Sub-contracting was the most common form of linkage identified through key informant interviews. In fact, 92 percent of the businesses interviewed were involved in some type of sub-contracting. Many of these business relationships did not involve work with small enterprises, although they did comprise businesses of under 50 employees.⁷ As will be discussed in more detail below, many businesses felt they could not get the service or product they needed from smaller businesses and as a result they were forced to turn to larger businesses.

Sub-Contracting Distribution



Those businesses which deal with small enterprises on a regular basis used them for low-tech jobs. A good example comes from Alexandria where one company relies almost exclusively on SMEs to undertake a range of small processing and manufacturing steps. This engineering firm uses small workshops to make steel mesh; cast iron molds; bend and shape metal parts; and manufacture small heat exchangers. All of this work is done by hand and does not require precise results as they are feeding into a larger product.

⁷ For example, out of General Motor's 60 sub-contractors, eight are SMEs, thirty-two are medium sized firms (between 20-70 employees), and twenty are large firms.

Business linkages between large and small firms are more commonly found in the service sector. For example, many hotels, restaurants, and manufacturers employ the services of smaller firms. The study found one large tourism organization in Alexandria employing small businesses for a multiplicity of services, such as gardening, cleaning, transportation, maintenance, and camera and video operations. This company also uses SMEs to supply their baked goods and deliver their raw materials. The chairman of this organization is very pleased with the services of his sub-contractors. He noted that:

As long as small businesses can supply the services I need I am happy to provide them with business.

For the most part, businesses freely admitted to their inability to effectively operate independently of other businesses. Their business, factory, or shop all require specialized products and services - often on a sustained basis. For large businesses and multinationals, these needs usually entail high quality, high volume production in a very strict time frame. Egyptian small businesses rarely possess these qualities and, as a result, are often relegated to producing labor intensive products and providing non-specialized services. The result seems to be more linkages occurring among the large and medium-sized firms than with small and micro enterprises.

Small Business in the Service Sector

The chairman of a travel company in Port Said was exuberant about the small businesses he utilizes. He gave a long list of small companies he often turned to for services that include the following:

Cleaning Service - for the beachfront and local restaurant.

Gardening - for the grounds and gardens of the hotel and restaurant.

Camera & Video Equipment - for weddings and other events at the hotel.

Musicians - for weddings and other special events.

Baked Goods - to supply his restaurant and food stands.

Guided Tours - outside the Port Said area.

Maintenance - of the hotel and restaurant facilities.

Transportation - for tourist transportation to and from the airport.

This example is characteristic of the general trend to employ small firms for relatively low technology products. When asked about architects, accountants, or graphic designers, most businesses relied on international or well-known organizations for these services.

Franchising

Franchising is not a broadly applied business linkage in Egypt. Whereas the franchising of international chains - such as McDonalds and Baskin Robbins - have been successful, local enterprises have not fully utilized this approach. One of the problems facing local franchises has been the limitations of the legal system to support these types of activities.

There are examples of local enterprise franchising that have been successful, particularly in the ready-made garments sector. One example is the garments manufacturer "Ness", based in Alexandria. After several years of operation, Ness had developed a good market for its product and decided to offer its products on a franchise basis. The idea has taken hold, and now Ness has franchise stores around the country selling its clothing.

Positive Attributes of Franchising

There are several positive attributes to franchising that make it appealing for work with small businesses. Below are a few examples: ⁸

A Proven Business Idea - franchises are a means of spreading a business idea that has been tried and tested.

Permanent Mentoring - a franchisor provides initial training, as well as on-going assistance to ensure that the franchise follows procedures. Because the earnings of the franchisor are based on the sales of the franchisee, it is in the franchisor's interest to ensure the franchisee succeeds.

Efficient Use of Capital - can reduce the need for start-up capital and reduce the start-up time, thereby reducing the need for working capital. Furthermore, franchises are more acceptable candidates for credit from financial institutions, thereby improving access to credit for small businesses.

⁸ These attributes of franchising have been taken from John Grierson and Donald Mead's report entitled, *Business Linkages in Zimbabwe: Concept, Practice, and Strategies*. GEMINI Working Paper No. 49. Washington, D.C.: USAID, 1995. p. 4.

Ness is also an excellent example of a firm relying on multiple layers of small firms to assemble a final product -- in this case an article of clothing. Ness has been instrumental in teaching its sub-contractors new skills; providing credit; and advancing their use of new technologies. In several cases, the owner has purchased new machinery for his sub-contractors to assure the quality control he needs over the end product.

There are other franchise opportunities in Egypt - such as the fast food industry. The fast food industry is experiencing a great deal of growth as small restaurants have begun to emerge to accommodate customer demand. However, much of the growth in this industry is through the establishment of new, family-owned branches. Franchising in the fast food industry could offer a lucrative opportunity for businesses to expand beyond family boundaries.

Other Forms of Linkages

As previously mentioned, sub-contracting was the main type of business linkage found in this study. Very few other linkage arrangements were identified between small and large firms. For example, only one instance of unbundling was discovered and the use of brokers was rare.

One instance of unbundling was detected in a large multinational pharmaceutical company in Cairo. At one point the company was manufacturing its own uniforms; it had a Sewing Department with its own policies, procedures and 10-person staff; and a Security Department with over forty employees.

Unbundling - occurs when an enterprise "spins off" one of its on-going activities. This is an act of down-sizing that is taken to further specialize firm activities and lower overall operational costs.

New management determined several years ago that this system was not functional. As such, it decided to restructure the Sewing and Security Departments and move these employees into other needed areas. Currently this pharmaceutical company utilizes a security service and purchases uniforms from a local manufacturer. It is confident that these measures to become more specialized will save the company time and money.

The use of brokers to facilitate business linkages was also found to be uncommon. Nevertheless, the need for this type of service was regularly mentioned by key informants, many of whom pointed to the widespread use of wholesalers to reach small businesses as an indication of the need for brokerage services.

For example, Atlantic Food Industries relies on a local wholesaler to obtain promotional products for its marketing campaigns. This wholesaler uses 10-20 small workshops to produce T-shirts, coffee mugs, and pens with the company's logo. Typical of most larger businesses, Atlantic Food does not want to invest the time and effort to coordinate its needs among multiple small businesses and finds this type of "brokerage" extremely useful.

Respondents also asserted that the limited use of brokers was related to their availability. A select few law offices and consulting firms offer brokerage services, although no formal brokerage houses exist in Egypt. Most firms agreed that a more formal brokerage system would reduce the cost and risk of identifying competent business partners.

Most firms agreed that a more formal brokerage system would reduce the cost of identifying business partners.

Conclusion: What Does It Mean?

Business linkages do occur in Egypt and constitute a significant part of the business economy's fabric. Linkages take place between small, medium, and large businesses for a broad range of services and, to a more limited degree, in the domain of manufacturing. For the most part, small businesses are commissioned for labor-intensive production and low-tech service jobs.

In order to truly benefit from business linkages, small businesses must begin to supply more advanced products and services that meet the quality, quantity, and delivery standards of larger organizations. Through these relationships they will benefit from exposure to more advanced technology, skills, and management practices.

Brokerage services were identified by respondents as a missing link that could facilitate interaction among small and larger businesses.

There are serious constraints that limit small and large firm interaction. Among these are small businesses' ability to deliver high quality, value-added products and services. The country's economic and policy environment is also an impediment to business collaboration. These and other issues will be discussed in the following section.

CHAPTER III

CONSTRAINTS TO DEVELOPING BUSINESS LINKAGES IN EGYPT

Business linkages have been slow to form in developing economies as their market structures often provide little incentive to encourage these alliances. Larger firms are discouraged from working with small businesses after a few bad experiences. The result has been the vertical integration of businesses to avoid the lack of quality control and delivery problems often associated with small business operations.⁹

There are a host of constraints that impede business linkages in Egypt. This quote reflects many of the comments made about SMEs by the businesses interviewed.

"I tried sub-contracting with one small business for over two years. In the end, I gave up."

In this case, the entrepreneur could not sustain the costs associated with contracting with an unreliable partner. In the end, he bought the necessary equipment and began manufacturing all of his inputs.

Vertically integrating a business is an extreme reaction to not finding a reliable supplier or manufacturer. This study did not find this practice to be widespread.¹⁰ However, the quote above echoes common problems: it is difficult and inefficient to work with small enterprises.

Below are the main themes that arose from key informant interviews concerning the constraints to interaction among small, medium and large businesses. For the most part, these issues deal with the small businesses in terms of their lack of quality control, management, marketing, skills, and access to credit. (See the bar chart on the following page for a breakdown of interviewee responses.) Interviewees were also asked about their views on the economic and policy environment in Egypt which affects their business and business linkages in general.

⁹ That is, firms often produce all of their own needs/inputs instead of purchasing them from sub-contractors or suppliers. Vertical integration limits firm specialization and is recognized as contributing to higher overall manufacturing costs.

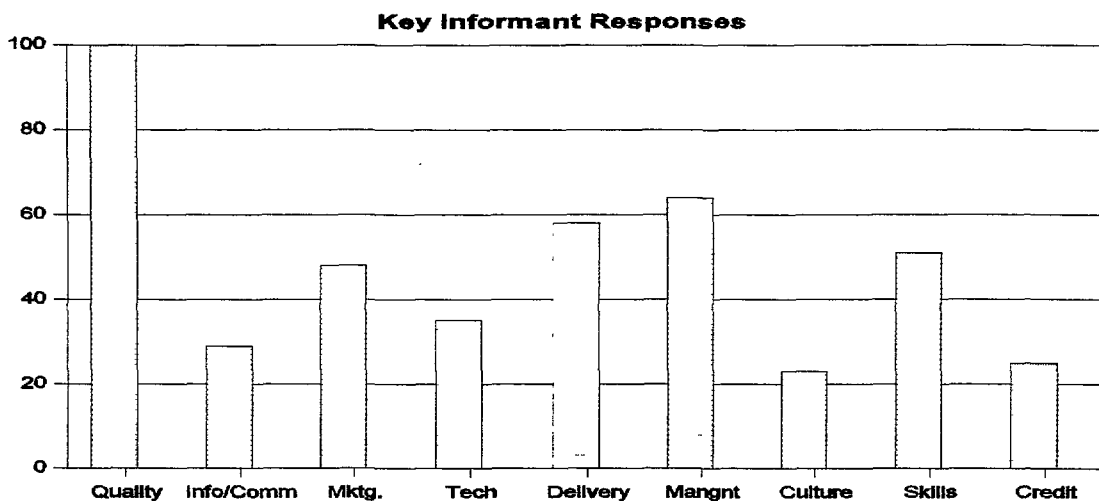
¹⁰ However, other studies on business linkages have noted the tendency in developing economies for businesses to vertically integrate. For example, Meyanathan's study on East Asian economies noted that: "In less developed markets, firms will often tend to choose in-house production in order to avoid the high transaction costs related to poor market development. Their unfamiliarity with potential suppliers raises the costs of gathering information and coordinating transactions with suppliers." p 5.

Issues of Quality

The issues raised by interviewees pertaining to small enterprises were expressed in various ways but always centered on issues of quality. Lack of quality control in small businesses was a distinct theme found in every interview expressed in terms of the following:

- ◆ **Management** - lack of appropriate management practices, procedures, and quality control severely limit a SME's capacity to produce a quality product.

Constraints to Business Linkages



- ◆ **Skills** - limited technical skills handicap small businesses' ability to produce quality goods and services. Insufficient training for managers and staff also contribute to lower quality goods and services. As discussed in the section above, the education and technical training system in Egypt has been unable to provide the private sector with the depth and range of skills it needs to produce internationally competitive products.
- ◆ **Technology** - limited access to new technologies impedes quality production for SMEs. Due to lack of opportunities to visit new facilities, share information, purchase new equipment, or even read journal articles, small businesses have few opportunities to learn about the most recent technologies.

- ◆ **Demand** - limited demand for high quality and high cost goods affects a small businesses' ability to profitably manufacture or deliver high quality goods and services.

These issues of quality emanate from a variety of small business practices and limitations. Below is a discussion of some of these associated constraints and how they relate to each other.

Management

A resounding 64 percent of businesses indicated that the lack of sound management skills and business practices in small enterprises was a constraint to developing relationships with them. Businesses demand a good quality product, at a reasonable price, that can be delivered within an appropriate time frame. All of these factors depend on efficient management.

Many small businesses are unable to meet one or all of these management criteria. Small businesses are handicapped by the management skills of their own staff. More specifically, since most businesses are owner-operated there is little opportunity for change. Owners have limited exposure to new ideas or management practices and are usually reluctant to change their operating procedures. The result for many small businesses is a lack of attention to quality control and to the provision of excellent service. Key informants often noted the general tendency of small businesses to overlook the "fine details" of production or service delivery.

The lack of management training also results in a limited competence to administer an office or factory. For example, it takes a great deal of organization and administrative efficiency to orchestrate the arrival of multiple inputs and the delivery of outputs. Small businesses therefore frequently suffer from late deliveries and a lack of customer satisfaction.

The shortage of training in accounting also leads poor cost projections. Many interviewees noted the tendency for locally-made products to be higher in cost than imported products or services.¹¹ As one entrepreneur stated:

Small businesses do not have the capacity to properly calculate their profit margins; as a result, they underestimated their waste, overestimate their efficiency, and overestimate their production capacities.

¹¹ This is not just a tendency of small firms, as a variety of locally made products were often cited by interviewees as being over priced. This trend continues, however, due to high import duties and tariff protection in certain sectors.

In the end, small firms end up charging more for their products due to inefficiently run plants, lack of organization, and inappropriate accounting and financial practices. As a result, many Egyptian businesses turn to imported products that can be cheaper and are often of better quality than locally-made products.

This trend has been partially confirmed by the research conducted for the 1994 World Bank study on business linkages in Egypt. This report found that many locally-made products were higher in cost and lower in quality than imported products.

Research for this report also noted the same tendency among local businesses. Examples given by key informants include some of the following pricing disparities:

Cotton Lining:

Locally manufactured cotton lining - LE 5/meter

Imported cotton lining - LE 3.38/meter

Resin:

Locally manufactured resin - LE 8/kg.

Imported resin - LE 5-6/kg.

In both cases, key informants considered the imported products to be of higher quality than the locally made variety.

There are other factors, of course, that are involved in higher prices - such as ready access to raw materials and the use of supplier credit. Nonetheless, the general inability to properly plan and manage human and capital resources leaves small firms unable to effectively compete in the Egyptian marketplace. Moreover, Government policies that set high import duties and protective tariffs also propagate these circumstances and allow local businesses to continue to operate in this manner.

Marketing and Information

Marketing and access to information are key constraints to developing business linkages between small and large firms. A large firm must know about small businesses and be able to assess their capabilities if they are to work with them. At the same time, small businesses need access to information about new technologies and changes in market demands.

Marketing

Over half of the businesses interviewed mentioned marketing as a major obstacle to working with small enterprises. Although larger businesses tend to identify local suppliers through word of mouth, many businesses believed that small firms should market their goods and services more aggressively.

Marketing goods and services, however, is an unknown concept to most small businesses. Like the rest of society, they rely on regular customers and family and friends to support their business. The result has been a lack of information on the products and services available through small businesses which, in turn, limits their ability to establish business linkages and long-term partnerships with larger firms.

Information and Communication

Small enterprises generally lack up-to-date information on new technologies, changes in the market, and purchasing data on buyers or suppliers. This lack of information undercuts their ability to develop the types of goods and services most needed in the market.

This lack of information occurs at several levels. Firstly, since most business is conducted through informal channels, small businesses lack the experience to gain access to more formal channels of information and data. Secondly, informants noted an unwillingness to share new ideas or work in cooperation with one another. In fact, many small businesses are wary of trusting anyone outside their immediate client group or family. The result is that businesses are left uninformed about market changes and quickly fall behind.

Access to communication networks was another missing ingredient noted by key informants. They remarked that small businesses lacked one of the most basic aspects of doing business, i.e., telephone and fax lines. Interviewees surmised that these

Small businesses lack the telephone and fax lines necessary to conduct business with larger firms.

information and communication deficiencies severely affected the ability of large businesses to work with small firms.

Skills

As will be discussed in the policy environment section, businesses interviewed were not satisfied with the skill level of workers in Egypt. The lack of technical and managerial skills in small businesses was considered a major constraint to increasing working relationships with larger businesses.

There are several factors that limit small businesses' ability to upgrade their workers' skills. For most small businesses, training is an expensive undertaking they cannot afford. Secondly, small business owners rarely acknowledge the need for training or the benefits derived from devoting resources in this area. Finally, many local technical training institutes and colleges do not provide quality training programs.

The case study below highlights the human resource gap existing among small and medium-sized firms.

Supplier Training

Glaxo Egypt has a dynamic training program for its staff and sub-contractors. The company quickly recognized during its initial manufacturing years in Egypt that training for its staff was essential. Over the years, this has developed into a formal training program for its suppliers and contractors in addition to its own staff.

Over the past decade, Glaxo has spent considerable time, money, and human resources to build quality training and skills up-grading programs for its suppliers and sub-contractors. It was the only firm interviewed that had a formal training program for its sub-contractors.

Credit

Lack of credit is a well known constraint for small businesses. It is perceived by most small businesses as the key obstacle to improving the quality of their production and expanding their operations. Lack of venture capital for the small business sector was also noted as an impediment to encouraging small businesses to pursue opportunities in market niches and new, untapped locations outside Greater Cairo.

Lack of credit was most often cited as a problem hindering the availability of appropriate machinery and/or technologies. Businesses interviewed believed that small businesses were often unable to produce to their specifications due to lack of appropriate equipment and technology, frequently a result of restricted access to capital.

Limited availability of funds was also deemed as a contributing factor to the lack of training and skills upgrading by small enterprises. As will be noted in the policy section, there is a tremendous need for management and skills training of Egyptian graduates, an issue that many small businesses are unable to address.

Entrepreneurial Spirit

Egyptian traditions and culture may, in some part, play a role in limiting the expansion of small businesses. Although a sensitive topic, enough key informants raised the issue for it to warrant discussion.

In general, local proclivities to work exclusively with family and friends were felt to limit potential interactions with larger businesses. More specifically, these tendencies result in a failure to: widely market their product; gain access to new sources of information; obtain cheaper and better quality of supplies; and explore new concepts such as franchising.

Many large businesses noted the disposition of small businesses to remain small. A number of businesses interviewed developed the impression that small firms were content to remain as they were. More than one firm gave examples of trying to approach small businesses with orders that would require an upgrading of skills, equipment, production quality, or efficiency. They were met with a reluctance to take on any additional "risk".

Whether a reflection of culture or training, interviewees remarked that small businesses often lacked the vision or long-term planning necessary to work collaboratively. Larger businesses felt that their demands often met with resistance because they required additional time, money, or resources.

The Economic and Policy Environment

Business linkages are facilitated by a strong economy and transparent policy environment. While a growing economy lends itself to increased business transactions, clear policies regulating business are crucial to encouraging their development and specialization. Below are a few findings of our field survey of Egyptian businesses concerning the economic and policy environment.

The Economy

The Egyptian economy has slowed in the last five years and is struggling to adjust to changing international conditions. The country's protectionist stance and public domination of key industries has also hurt the economy. Whereas business interactions are a vibrant part of the Egyptian economy, its slow growth has limited the potential of these relationships.

The domination of some sectors of the economy by the public sector was viewed by many interviewees as a significant deterrent to developing businesses linkages. Many respondents felt that the management practices and employment policies of these public firms led to widespread inefficiencies and low quality products. These findings are corroborated by the 1994 World Bank study on business linkages in Egypt:

Specifically, many public sector companies have excess manpower that they try to keep as productively employed as possible. Therefore, they opt to produce as much as possible in-house rather than source from other companies. In addition, their management philosophy often appears to favor control over as much of the production and marketing process as possible

On the other hand, the majority of businesses interviewed expressed a belief that the economy would grow and expand in the years ahead. Many of these businesses already had expansion plans in the making and were pleased with their firm's growth over the last few years.

The Policy Environment

Egypt's policy and regulatory environment hinders business linkages. Through its lack of uniformity, overlapping regulations, and general bureaucratic ineptitude a policy environment exists that is cumbersome to businesses and limits business interaction.

The same World Bank study went on to note that if the country chooses to encourage a more active network of business linkages, there has to be a system in place that is free of bureaucratic procedures, customers clearances, traffic bottlenecks, production interruptions, labor strikes, communication and transportation breakdowns, and infrastructure overloads.

These themes were echoed by key informants. Seventy-five percent of those interviewed considered Egypt's policy and regulatory environment as an impediment to business development. More than half of these stated that the policy environment was a significant constraint to conducting business. Issues raised by interviewees included the following:

- ✓ **Legal Framework** - In general, businesses felt that the legal system did not give them a functioning "framework" within which they could conduct business. Since mechanisms do not exist to enforce most business laws, the business community is often left to develop its own systems to conduct business. The Contracts Law in Egypt was most commonly cited as lacking the necessary clarifications and rigor to support business transactions. Legal barriers also exist for "informal" and "formal" businesses to collaborate.

- ✓ **Privatization** - Local businesses feel that the government's reluctance to aggressively pursue privatization made them hesitant to believe its assertive policy position. Firm executives also surmised that the economy would benefit from less public sector domination of key industries.

- ✓ **Tax System** - A constant complaint of all business people is the tax system in Egypt. The general confusion and lack of understanding - even by government officials - of how to apply the tax system left businesses confused and exasperated. Some key informants felt that the system discouraged profit-making initiatives due to a high tax rate for profits.

The result was that most businesses were reluctant to show profits on their accounts. Sales tax rates were also mentioned as a stumbling block in competing effectively in international markets.

- ✓ **Import Duties** - Many businesses indicated that the Government's protective import barriers render the Egyptian manufacturer less cost competitive and less quality oriented. Businesses are also discouraged by the Government's tendency to change tariff rates and taxes at will, making it very difficult to develop long-range plans and accurately project profits and losses.

- ✓ **Government Pricing and Supplier Control** - Local businesses complained about the availability and price of products (such as molasses, sugar, and until recently, cotton) that are controlled by the government. These businesses felt that Government monopolies and price controls had the effect of increasing their costs and hindering production flows.

- ✓ **Local Content Requirement** - The policy that requires multinationals to purchase set quotas from the local market has the potential to hurt both international and local firms. The repercussions of this policy can be significant. In some cases, it has raised the overall costs for manufacturers and led to lower quality, products at higher costs.¹²

- ✓ **Financial Systems** - Egyptian entrepreneurs often noted the lack of an efficient banking and financial system as a constraint to business operations throughout the country.

¹² For example, one automobile manufacturer stated that they paid 10 percent more for lower quality, locally made tires than imported tires.

- ✓ **Intellectual Property Rights** - Many of the multinationals interviewed for the study noted the lack of attention to intellectual property rights as a major problem for conducting business in Egypt. This disregard discourages international investors and franchise opportunities.

Buying Products Locally

Although the policy of local content requirements is a controversial topic, many economists agree that it does not encourage the competition necessary to build a healthy economy. The following is one example of an Egyptian business's struggle with local content requirements.

A multinational company established itself in Egypt 12 years ago to manufacture for the local market. Due to existing laws, they are required to purchase a great deal of their inputs locally, which they do through hundreds of sub-contracting arrangements with small, medium, and large firms.

Today, the multinational purchases more than their minimum quota locally due to Government incentives, such as lowering duties on their other imported items as they move above their quota.

On the other hand, their relationship with local firms has come at a price. Firm executives noted that most of the products they purchase locally are not only more expensive than imports (from 10-100% more), but they are also poorer quality. In the end, this has meant higher overall costs for the company which have only been off-set by tax holidays and a protected local market.

- ✓ **Labor Laws** -- A number of businesses regard Egypt's labor laws as a constraint to managing their businesses efficiently. These complaints are based on the fact that poor worker habits could not be eliminated due to tightly controlled hiring and firing practices.
- ✓ **Educational System** -- Due to the quality of the educational system in Egypt, many businesses feel they cannot acquire the needed skills in-country. The result is low quality workmanship and incompetent managers. Many key informants noted that they spend considerable time and money training their new staff in areas such as: computers, languages, writing, and customer service.

- ✓ **Bureaucracy** -- Most businesses interviewed considered the Government's overall bureaucracy as a contributing factor to the negative policy environment. Most felt that the government's sluggish response to business needs and the disorganization of its offices impedes businesses from operating efficiently and leads to corruption. Several businesses cited specific examples of facing different answers and different applications of the same rules, leaving them with the impression that government officials could change their mind with no regard to established policies or laws.

The Government was also criticized by business people throughout the country for not developing and implementing better regional plans. As a result, many felt that there was a lack of proper infrastructure (including roads, telecommunications, and water and wastewater) to support business growth. The lack of regional plans has also led to poor planning and the destruction of environmental resources, such as has occurred along the Mediterranean coast.

Conclusion

Regardless of the above noted problems, many interviewees believed that new businesses were starting, expanding, and gaining international recognition. Many entrepreneurs asserted that they have learnt how to work within the existing policy environment; get around problem areas; deal with recurrent problems; and perhaps more importantly, they have acquired a good understanding of what *could* and *could not* be done within their existing circumstances. This is how businesses survive and thrive in Egypt.

The respondents also stipulated that the government could do much more to support the business community and encourage business linkages. These perceptions were summarized by one businessman:

I would like to see more clear direction from the Government in terms of supporting business linkages and business development in Egypt. If this happened, these [business linkages] would occur more frequently.

The constraints to business linkages in Egypt are consistent with other country experiences. In addition to policy conditions, many of these issues center around problems at the small business level. Through their consistently low quality products and services, SMEs discourage affiliations with larger firms.

Targeted project interventions can break this cycle and help small businesses better meet the needs of larger firms. The following section will discuss strategies to design successful business linkage endeavors.

CHAPTER IV

DEVELOPING BUSINESS LINKAGES

Developing and developed countries have taken different approaches to encouraging business linkages. Some of these experiences are summarized below, along with a presentation of the basic characteristics of successful business linkage programs.

Business Linkage Experience

A variety of different approaches have been used to encourage business linkages around the world. A few of these initiatives have been successful, as in Taiwan, Korea, and Ireland. The success of these programs can be attributed to their emphasis on long-term impact, focusing on sound market strategies to convince large firms of the merits of working with smaller businesses.¹³

Korea

Korea's strategy to foster business linkages has been to create a policy environment that facilitates these relationships. For example, in 1985 Korea adopted the Linkage Guarantee Scheme that gave preferential guarantee service to enterprises that served as sub-contractors to larger enterprises. Financial and fiscal support were made available to SMEs involved in sub-contracting, and tax deductions were given for investments made in laboratory and inspection equipment. Under this program, expenses incurred for technical assistance by the parent firm were treated as losses. As a result, sub-contracting has grown rapidly, accounting for 42 percent of the value of the manufacturing sector by 1986

Korea has also launched the Small and Medium Industry Promotion Corporation that works with small businesses to establish business cooperatives. The cooperatives are designed to help SMEs jointly purchase raw materials and sell their products.

¹³ The Korean and Taiwanese case studies were taken from: Saha Dhevan Meyanathan. *Industrial Structures and the Development of Small and Medium Enterprise Linkages: Examples from East Asia*. Economic Development Institute. Washington, D.C.: World Bank, 1994. p. 11.

Taiwan

Taiwan's business linkage efforts provide another interesting example as the Taiwanese economy is dominated by small enterprises (firms with less than 50 employees account for more than 91 percent of all registered firms). In general, the government has supported business linkages in a few key sectors that have high business linkage potential.

In Taiwan, the government has supported small business development through its educational system; it has attempted to upgrade its labor through the general educational system and through the development of strong vocational-technical training programs.

The government has also worked to upgrade SMEs' management, accounting, and access to new technologies through the creation of a Center Satellite Factory System. This Center is a coordinating institution that works to upgrade the quality and industrial development of businesses by encouraging collaborative efforts. It also provides access to technical assistance and management programs aimed at improving the managerial and technical capacity of SMEs.

Ireland

In the late 1980s the government of Ireland developed a National Linkage Program (NLP) to coordinate all state organizations' activities in order to enhance backward linkages and implement business linkage initiatives. The objective of the NLP is to develop local vendors into quality, reliable and price competitive suppliers to large buyers at home and abroad.

The program's short-term goals are to identify industrial linkage potential within targeted sectors; to develop a set of domestic suppliers; and to offer buyer support and development services. NLP is a consortium of organizations, with each member contributing to its central staff. The staff all have technical expertise in areas such as engineering, biology, human resource development, and accounting.

NLP performs the following: (1) market research - to identify backward linkage opportunities; (2) matchmaking - through a computerized database to link up suppliers and buyers; (3) monitoring - to assist business partnerships through the contractual and implementation stages; (4) technical assistance - for technical and managerial support; and (5) referral system - to help clients access the domestic and federal assistance programs.

Through the identification of market niches, NLP has been able to help domestic suppliers carve out market niches for themselves within identified sectors. NLP is considered a success by many because of its use of existing market mechanisms and its economically motivated agenda.

For the most part, business linkage programs have struggled, suffering from high costs and low impact. Too often they have tried to implement programs that serve many businesses through generalized services. The private sector response has been predictably unenthusiastic to these efforts. Other problems endemic to business linkage ventures include the following:¹⁴

- ◆ Lack of private sector involvement;
- ◆ Inconsistencies in program implementation (across multiple agencies and institutions);
- ◆ Lack of communication between and among implementing and coordinating agencies;
- ◆ Unfair regulatory burdens placed on SMEs through the existing policy framework; and
- ◆ General lack of managerial accountability.

Malaysia:

Problems in Promoting Sub-Contracting

The Government of Malaysia has taken various steps to support the expansion of business linkages in their country. One of these efforts has included the establishment of a Sub-Contracting Exchange Scheme (SCX). This program has run into a variety of problems that are endemic to developing country settings:

- Small producers would quote higher prices than international market prices.
- Small producers would provide inaccurate information into the SCX database regarding their capabilities, specialization, and production facilities.
- A limited number of small producers had the capabilities to meet international standards.

As a result of some of these problems, the Government has instituted an Industrial Technical Assistance Fund (1990) to assist smaller businesses to up-grade and modernize their operations. The private sector has also taken its own initiative to support overall business development through the creation of the Human Resources Development Fund (1992) to encourage industrial enterprise training.

¹⁴ Programmatic problems were taken from: Saha Dhevan Meyanathan. *Industrial Structures and the Development of Small and Medium Enterprise Linkages: Examples from East Asia*. Economic Development Institute. Washington, D.C.: World Bank, 1994. p. 9.

The more successful programs have been able to supply targeted, responsive services to businesses. For example, some programs have developed on-line computer services that rapidly identify a range of potential sub-contractors or suppliers. Other initiatives have used sector specialists to bridge the gaps between small and large businesses and solve problems quickly. Although expensive, these programs seem to have a better overall impact from their services than more generalized programming.

Programming Characteristics

Several key lessons emerge from the case studies presented above as well as work in other countries. Many of these lessons concern issues of project design, goal setting, policy and economic factors, and institutional structures. Some of the more general programming characteristics are described below.¹⁵

Market Driven	Business linkage projects should build on the economic demands of the business community. They should be market driven. If a business linkage initiative can properly meet existing market demand - over time - demand will become self-generating and the project will become self-sufficient.
Collaboration	Business linkage projects must seek to build and solidify collaborative partnerships between and among businesses. Through this process enterprises will be able to share information, technologies, and management practices. This process, labelled "buyer-mentoring", should be integrated into all business linkage arrangements.
Institutional Arrangements	Business linkage projects should build on existing local institutional efforts. Care must be taken to establish clear lines of authority and coordination among all government entities involved in business development. The Asian business linkage experience demonstrates that interventions work best if only one institution (or a strong, coordinating agency) implements or delivers program services.

¹⁵ Many of the concepts presented here are taken from the ground breaking work done by John Grierson and Donald Mead in Zimbabwe; based on their report entitled, *Business Linkages in Zimbabwe: Concept, Practice, and Strategies*, GEMINI Working Paper No. 49. Washington, D.C.: USAID, 1995.

Information

Businesses linkage projects' delivery of information can provide a centerpiece to initiate dialogue among businesses and render a point of departure for further collaboration.

Access to information is important for both buyers and sellers:

- (1) Buyers must have access to information on new and potential suppliers.
- (2) Sellers (and small businesses in particular) need access to the requirements of potential buyers, new technologies, and pricing information.

**Policy
Orientation**

Business linkage efforts must be sensitive to the overall economic and policy environment. Projects must be designed based on these conditions that will allow linkage initiatives to take on market-driven characteristics.

The policy framework can be a barrier to business linkages if large firms do not appreciate the benefits of using small enterprises. Many governments in Asia have built policy incentives into their business linkage endeavors, including tax incentives and tax holidays.

Credit

Business linkage projects should strive to reduce overall capital requirements of SMEs. Programs can do this by encouraging participants to use available capital efficiently, by enhancing access to available credit sources, and encouraging buyer-mentoring.¹⁶

Business linkage projects should also be designed to strengthen a small businesses' leverage with and access to the formal financial system. While it is quite common for buyers to provide manufacturers with credit, these may not always be the most cost effective for the small businesses. It is preferable that they develop their own direct relationships for obtaining credit.

Business linkage assistance programs have met with varying degrees of success. These initiatives have been plagued by a lack of private sector involvement, inconsistencies in program implementation, and unfriendly policy environments.

¹⁶ Ibid. p. 8.

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ANNEXES

ANNEX A - List of key informants

EXECUTIVE SUMMARY

Businesses working together in short- and long-term partnerships are the thrust of this report. Often termed business linkages, these relationships are an important aspect of most economies.

Although business linkages have been slow to occur in developing economies, they offer a variety of benefits for small and micro enterprises. As a result of these collaborations, small and micro enterprises can develop the capacity to increase their efficiency, upgrade their technology, and improve their technical and managerial skills. Documented Asian experiences also reveal that business linkages can help SMEs gain the technical and managerial capacity to meet international quality standards.

Business linkages are relatively unexplored in Egypt. In particular, the benefits and disadvantages to small businesses has received little attention.¹ Accordingly, USAID has become interested in studying business linkages in Egypt and their role in addressing some of the traditional constraints to small and micro enterprise development.

Business Linkages in Egypt

Business linkages do exist in Egypt and are an important part of the country's economy. Businesses rely on other businesses to supply raw materials, inputs, and technical/specialized services. Although they may not be as widespread as in Europe or North American, this study found a limited but active linkage system in place.

Sub-Contracting

Sub-contracting was the most common form of linkage identified through key informant interviews. In fact, 92 percent of the businesses interviewed were involved in some type of sub-contracting arrangement. Many of these business relationships did not involve work with small enterprises, but with medium and large-scale firms.

The most common form of sub-contracting with small businesses was found in the service sector (57 percent). A typical example would be a tourism company that uses a range of small businesses to provide services, such as gardening, cleaning, maintenance, transportation, or prepared foods.

¹ The definitions of small, medium, and large enterprises are based on USAID/Cairo's utilization: small enterprises have fewer than 20 employees; medium enterprises range between 21-50 employees; large firms have more than 50 employees.

The most successful programs have been able to supply targeted, responsive services to businesses. More general, broadly targeted programs have achieved poor results. Albeit expensive, targeted and hands-on programs seem to have a better overall impact in encouraging and expanding business linkages. The issues raised above are basic elements that should be considered when designing a business linkage project. Other questions that should be asked during the design process include the following:

- (1) Do major economic or policy constraints exist that would significantly hamper a business linkage program?
- (2) Will the government be willing to actively participate in a business linkage effort and will they support the necessary policy changes to encourage business partnerships?
- (3) Which sectors offer the greatest opportunity to promote business linkages?
- (4) How will the project coordinate its efforts with the multiple agencies already involved in business development?
- (5) Will the domination of one central coordinating agency responsible for business linkages create political in-fighting, and if so, how will the project deal with this?
- (6) What cultural or societal factors need to be taken into consideration during the design and implementation stage?
- (7) Has a thorough needs assessment been done to determine the viability of promoting linkages? Can the following questions be answered: What has the business community identified as its own needs and priorities? Can a business linkage effort be designed to meet these market demands? Can a new program be self sustaining?

Of course there are many other issues and problems to resolve when designing a new project. It will be a country's social, economic, and policy conditions that will shape any effort.

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Conclusion

This section has summarized a range of approaches taken to encourage business linkages. While some of these measures have been successful, many have not. Although each country experience has been different, one key element has remained the same: the centrality of the private sector's involvement.

Those programs that have worked -- both in terms of impact and cost recovery -- have included the private sector from the outset. Businesses have been involved in the design and implementation of these programs. As a result, programs have been demand-driven and effective.

The final chapter attempts to draw on these lessons learned and examine some opportunities in Egypt to design appropriate systems to encourage business linkages.

CHAPTER V

POTENTIAL INTERVENTIONS

Targeted interventions could be designed to increase business linkages in Egypt. The key to the success of these efforts will be to garner the private sector's input from the outset.

Since any business linkage effort will seek to expand current levels of collaboration, it will need to closely match the demands of this sector. As such, the first recommendation of this report is to initiate formalized dialogue with key business people and business groups to solicit their ideas and concerns.

The private sector's participation in the design of any new intervention is critical.

Program design efforts must also coordinate closely with the Government of Egypt and concerned Ministries. Attention must be given to orchestrating the activities of the multiple Ministries working in business related matters. The Government's willingness to establish new business linkage policies (such as tax incentives or contract set asides) will also be critical to enabling a new project to flourish.

The following presents a phased strategy to study the potential of a business linkage initiative. It involves a preliminary investigation through a sub-sectoral analysis and the subsequent design of a pilot project.

Sub-Sector Analysis

One of the important aspects of successful business linkage endeavors is their sectoral focus. It will therefore be imperative to identify and study sectors that have the greatest potential for sustaining business partnerships in Egypt. These sectors should be characterized by: (1) limited public sector involvement; (2) a wide range of enterprises/small businesses; (3) the potential for technological advances; (4) an active private sector; and (5) limited impediments to expansion and diversification.

Sub-sector research focuses on the study of production and distribution "systems" within an economy. By focusing on a single product or market, sub-sector research facilitates the identification of constraints affecting small and large firms.¹⁷

¹⁷ Boomgard, et. al. *A Subsector Approach to Small Enterprise Promotion and Research*. GEMINI Working Paper No. 10. Washington, D.C.: USAID, 1991. p. 4.

Potential sectors in Egypt that warrant further attention include:

Food Processing

Food processing (including tobacco) represents one of the largest sectors in Egypt. It contains a mix of publicly and privately owned industries. Some sectors are totally government owned including, most beverages, tobacco, and sugar processing.

The food processing industry holds a variety of opportunities for small businesses. Some industries -- such as confectioneries -- need a range of inputs that can often be supplied locally. In addition, the food processing business has many packaging requirements that can be met through small, local producers. For example, Cadbury/Egypt asserted that in 1991 they imported all of their packaging requirements and by 1995 had switched to entirely locally-made products.

Furniture and Wood Working

The local furniture industry in Egypt currently produces for the local and international market. Much of this sector is dominated by very small workshops that manufacture and assemble low quality furniture. As a means of sharing skills and machinery, this sector has formed a network of collaborative production that needs further investigation.

Automotive

Although this industry is dominated by the public sector and is highly protected, there are a range of opportunities for increasing linkages among the smaller feeder industries. This industry has a growing demand for a range of small parts and components, metal works, and glass products. General Motors claims that 60 percent of its inputs are from local sources, about 15 percent of which is from small businesses.

Ready-Made Garments

The ready-made garments industry is dominated by small, private firms. Growth has been strong with export quadrupling between 1987 and 1991. Due to the nature of its production, this sector requires many small inputs -- such as zippers and buttons - that have been met through local production. In addition, the garments industry is well known for sub-contracting out the assembly of final products to smaller businesses.

Metal Working

The metal working industry employs a mix of small and large, and public and private companies. Much of their work tends to be specialized, according to individual manufacturing orders.

The metal industry also has hundreds of very small workshops that manufacture, refine, and shape metal products for larger manufacturers. One steel works visited in Alexandria relied exclusively on small workshops to perform small tasks such as bending and shaping pieces of steel; however, more specialized work was usually done in-house.

Tourism

The tourism sector includes hotels, restaurants, and travel agencies. Although the government owns many of the larger hotels, most properties are managed through private management leases.¹⁸

The hotel industry offers a range of possibilities for business linkages. Hotels interviewed for this study use a variety of services from small businesses, including: laundry, gardening, security, graphic artists, printers, musicians, and cleaning services. Hotels also contract with small companies for the purchase of towels, carpets, furniture, and other furnishings.

Restaurants and travel agencies also require a range of products and services for their operations. For example, one well known restaurant interviewed in Alexandria uses a local bakery to produce all of its cakes and pastries. Other services needed by restaurants include: cleaning, security, and graphic artists. Several of the travel agencies interviewed remarked that they usually dealt with small businesses to supply them with a variety of small services such as transportation, photography, and translation.

Construction Sector

The construction sector is characterized by several large and medium sized firms and many small enterprises. In terms of numbers, the majority of firms are private. This sector provides a unique opportunity for small businesses as most construction operations entail collaboration with multiple firms, each specializing in their own business (electricity, installments, plumbing, water-proofing, or brickwork). All of the construction companies interviewed for this study indicated their heavy reliance on smaller contractors to undertake specialized services.

¹⁸ As noted in the World Bank study, the government controls about 45 percent of the rooms (either through completed ownership or through joint venture arrangements) in all four and five star hotels in Egypt.

Once the potential sectors have been identified, a thorough sub-sector analysis should be conducted in each sector to gain a better understanding of all the key players, their problems and weaknesses, and their long-term business needs.

Upon completion of the sub-sector analyses, USAID will have the requisite information to judge the merits of each sector's potential in facilitating long-term business partnerships between small and large firms.

Pilot Program

Based on the information gathered in the sub-sector analyses, a pilot program can be implemented in one or two of the identified sectors. This pilot program could test the waters for a larger endeavor, as well as develop illustrative examples of business linkages.

The key guide throughout this process must be the *mutual* profitability of any linkage opportunity. If this issue is kept at the forefront of all decisions then only viable, sustainable relationships will be built.

The pilot program would work closely with the most competent small businesses to initiate business linkages such as sub-contracting. Selecting the most suitable businesses will be critical to ensure early program success.

In addition to establishing successful examples, the pilot initiative will also assess the following:

- ◆ The need for targeted technical assistance in areas currently unserved by existing training programs (such as contract negotiations).
- ◆ The practicality and cost of developing an on-line database to support the identification and partnerships of buyers and sellers. The opportunities to cooperate with existing similar efforts to establish on-line systems.
- ◆ Potential private partner organizations.
- ◆ Key government bodies and individuals involved in small business development or business linkages.
- ◆ The viability of developing joint supplier and marketing assistance for SMEs (e.g., Cooperatives).

- ◆ The level of demand for dispute resolution and/or contract negotiation support.
- ◆ The need for additional credit facilities -- including venture capital -- for small and micro enterprises.

The focus of the pilot activity will be to test out very targeted techniques. While labor intensive, this method also provides a quick, highly technical intervention that meets private sector demands.

After the first year of operations are completed and the above information is gathered, the pilot will be able to move into more concrete activities, such as:

- ◆ Identifying market niches for small businesses.
- ◆ Developing profiles on all key small and large industries in targeted areas.
- ◆ Discerning critical technological and information gaps (on the part of the small businesses).
- ◆ Supplying SMEs with technical and managerial advice, assistance with quality control, human resources development, and accounting.
- ◆ Acting as an intermediary to make referrals to other Governmental and non-governmental business support programs.
- ◆ Monitoring on-going business linkage activities.

By quickly establishing successful cases of business linkages, this project would prove the value of its assistance. Gradually, it would be able to recover costs by charging for its services, eventually becoming totally market-driven. If this can be achieved, a truly successful, sustainable program will have been created.

Conclusions

This study provides a wealth of evidence on the significance of small, medium, and large businesses working together. By working side by side, they support private sector specialization, lowering transaction costs and allowing firms to more readily meet changing market conditions. While business linkages are advantageous to the overall economy and to firms of all sizes, they provide particular benefits to small business.

The evidence gathered through key informant interviews demonstrates that there is an active business linkage system throughout Egypt. Large businesses turn to smaller ones, and vice versa, to meet their production and service needs. Although most of these relationships are limited to the sub-contracting of services, there are indications that both franchising and brokerage could increase through targeted interventions.

The problems Egypt faces to promote business linkages are not unique. Most developing countries' small businesses are constrained by their own human resources, lack of access to new technologies and information, and limited capacity to effectively market their products and services. In addition, Egypt is faced with a wide range of policy and regulatory bottlenecks which obstruct business development in general, and business linkages in particular.

The main challenge for the country is to find its own methods to successfully expand the economy while working within its current political, social, and cultural climate. Business linkages offer one opportunity, among others, to initiate this expansion. The ideas presented in this report may be a first step in the promotion of business linkages. One step at a time, with businesses helping other businesses, Egypt may be able to meet its challenges in the years ahead.

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ANNEX A
LIST OF KEY INFORMANTS

BUSINESSES

Alexandria Engineering Works
Dina Ahmed Awad
Manager

Arab Development &
Technology
Ahmed Azim
Vice President, Marketing

Atlantic Food Industries
Hany El Khatib
Regional Marketing Manager

Barragoda, International
Nabil Barakat
General Manager

Cadbury Egypt
Mohamed Nour
Managing Director

CIAK Manufacturers
Salah Abdel Aad
Manager

EFI, Interfoods Egypt
Sami Tuqan
Managing Director

Egyptian Garments & Knitwear
Mahmoud Fahmy
President

Egyptian Traders
Fathi Atout
Director

General Motors
Ziad Nashif
Chairman

Glaxo Egypt
Taher Salem
HRD Manager

Hilton (Ramses)
Rene Yelanguézian
Manager

International Confectionery Co.
Ibrahim Yassin
General Manger

Lord Co. for Trade & Industry
Aly Soliman
Engineer

Nes
Anwar Akl
Manager

Pfizer
Charles Sarris,
Regional Manager

Port Said Garments
Walid Mostafa
Manager

Port Said Travel
Hamed El Shenawy
Chairman

San Giovanni Investment
and Tourism Company
Sedki Zaki
General Manager
and
Nabil Betsy
Marketing Manager

SIAC, Industrial Construction
& Engineering
Adel El Shafei
Business Development Advisor
and
Nehad Ragab
Chairman

SODECO
Medhat F. Riad
Managing Director

Trianon, Corp
George Louka
Partner

Zahran Industries
Alaa Zahran
Manager
3M
Wayne Garrett
General Manager

DONORS AND NON-GOVERNMENTAL ORGANIZATIONS

ABA
Nabil Shawmey
Executive Director

Agricultural Cooperative
Development International
Dave Davies
Vice President
and
Anne R. Johnson
Project Advisor (RCID)

CARE
Dan Coster
Program Manager

CEOSS
Mohsen Kamel
Managing Director

CRS
Magdi Sidhom
Deputy Country Representative

EQI
Randa Fahmy
Vice President

EQI
Sayed Hassanein
Senior Site Advisor

EQI
Ezz El Sharkawy
Senior Site Advisor

EQI
Mohammed Haseeb
Senior Site Advisor

GTZ
Michael Feichtmair
Specialist for ABA

International Development
Research Center (IDRC)
Maurice Saada
Program Officer, SME

NCBA
Fernando Cruz-Villalba
Chief of Party

SEDAP
Sayed El Issawy
Director

BANKING AND FINANCE ORGANIZATIONS

Credit Guarantee Corporation
Ahmed AS Zaki
Chairman

Finance & Banking Consultants
International (FINBI)
Amr Hassanein
Manager

World Bank
Marcelo Guigale
Senior Economist

United Securities
Dr. Rashwan
President